FILE COPY

Office - Supreme Court, U. S.
FILED
OCT 7 1942
CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1942.

IN THE MATTER OF

CHICAGO, MILWAUKEE, ST. PAUL AND PACIFIC RAILROAD COMPANY,

Debtor.

No. 13

GROUP OF INSTITUTIONAL INVESTORS AND MUTUAL SAVINGS BANK GROUP,

Petitioners,

VS.

ISRAEL A. ABRAMS, ET AL.,

Respondents.

No. 32

RECONSTRUCTION FINANCE CORPORATION,

Petitioner,

VS.

CHICAGO, MILWAUKEE, ST. PAUL AND PACIFIC RAILROAD COMPANY, ISRAEL A. ABRAMS, ET AL.,

Respondents.

BRIEF FOR THE RESPONDENTS.

MEYER ABRAMS,
Counsel for Israel A. Abrams, et al., Adjustment Mortgage Bondholders, Respondents.

SHULMAN, SHULMAN & ABRAMS,
134 N. LaSalle St., Chicago, Illinois,
Of Counsel.

Dated: October 5, 1942.

INDEX.

PAGE

The Statement of the Case 2

(a) The Specific Objections of the Respondents Urged Below 3

(b) Disposition Below 4

(c) The Primary Issue 4

ARGUMENT.

A.

The Decision of the Court of Appeals That the Plan Cannot Be Approved in the Absence of a Determination As to the Value of the Whole Estate and the Value of the New Common Stock Given in Exchange for the Adjustment Mortgage Bonds Is Correct and Should Be Affirmed 7

I. The change of the position of the Adjustment Mortgage Bondholders from secured creditors to common stockholders without voting rights upon the arbitrary allotment of 1,788,655 shares, without determination of their value, made the plan discriminatory, unfair, inequitable, and in violation of the Fifth Amendment and the Court of Appeals properly reversed the approval of such a plan 7

(a) An exchange of bonds for stock must be fully compensatory and the No Par Value Stock at a stated value but of no actual value did not afford such compensation 8

(b) The valuation is in excess of the capitalization 11

II. The plan which allowed new securities on account of accrued interest to all other security holders up to December 31, 1938, and did not allow any new securities on account of the accrued interest of approximately $80,000,000 on the Adjustment Mortgage Bonds unfairly discriminated against them in violation of Section 77 15

(a) The Adjustment Mortgage Bondholders were entitled to new securities in payment of the accrued interest to the same extent as the senior securities in the absence of a finding that the estate of the Debtor was insufficient to pay such interest 15

III. Even if it was proper to change the position of the Adjustment Mortgage Bondholders to that of stockholders, it was improper to deprive them of their voting rights 16

(a) A plan which is approved by a court in advance of the approval by the creditors must be the best plan obtainable 17

(b) A plan which compels secured creditors to become common stockholders without the right to manage the property is not only not the best plan but is unfair and inequitable 17

(c) While a voluntary voting trust may be created it is against the public interest to create such an involuntary trust and to deprive stockholders of their rights 21

(d) The creation of the voting trust is in violation of the Illinois Constitution 25

IV. The surrender of the claim of the Adjustment Mortgage Bondholders as creditors on the free assets in favor of the senior securities who will remain the only creditors, discriminated inequitably in favor of the senior creditors and the debtor in violation of the Act 26

(a) Section 77 does not authorize the taking away of the claim of one creditor in favor of another creditor 27

(b) The plan which wipes out all stockholders and relegates the position of the Adjustment Mortgage Bondholders to stockholders who may be wiped out is not compatible with the public interest 28

B.

The Contentions of the Petitioners That the Court of Appeals Erred in Reversing the Approval of the Plan in Remanding the Case for a Determination As to Value, Are Devoid of Merit 30

I. The decision below did not misconceive the purpose of Congress in enacting Section 77 and it does not render that statute ineffective 30

(a) The requirement of Section 77 that the Commission shall state its reason for its conclusion applies to a report refusing to approve a plan, and is inapplicable to a report approving a plan where findings are expressly required 31

(b) Findings as to value are necessary when a plan proposes the exchange of securities and creditors are not made "whole" 31

(c) When a plan contemplates to give only partial consideration to a class of creditors the valuation becomes necessary as a matter of law 32

II. The plan failed to comply with §77 37

(a) Requirement of Statute 37

(b) The Plan as presented by the parties and as modified and approved by the Commission 39

(c) The changes sought by the respondents challenge the failure of the Commission and the District Court to make the proper determination within their respective jurisdictions 40

III. In discharging its duties under Section 77, the Commission did not support the certified plan by any determination as to value which was necessary under the Plan 41

(a) The Commission did not state its determination as to value as required under Section 77 (e) 41

(b) The report does not contain any findings as to the valuation of the Debtor's property as a whole 43

1. There is no determination of the value of the new securities available for distribution 43

2. Exclusion of the preferred and common stock 44

(c) Findings as to Additions and Betterment Fund 44

(d) The findings as to each of the several mortgage divisions 45

Conclusion 47

CITATIONS.

Atchison Ry. v. United States, 295 U. S. 193 39

Babcock v. Chicago Railways Co., 325 Ill. 16 22

Carter v. Kurn, 120 F. (2) 261 38

Case v. Los Angeles Lumber Products Co., 308 U. S. 106 ..... 27, 28

Chicago, R. I. & P. Ry. Co., In re, 90 F. (2) 312 ..... 7, 11

Commission v. Sanders Radio Station, 309 U. S. 470 29

Consolidated Rock Products Co. v. Du Bois, 312 U. S. 510 ..... 8, 17, 30, 33

Felt, et al. v. U. S. Mortgage & Trust Company, 231 Ill. App. 110 23

First National Bank v. Flershem, 290 U. S. 504 29

Ginsberg v. Lindel, 107 F. (2d) 721 11

Interstate Circuit Inc. v. U. S., 304 U. S. 55 39

Jamieson v. Watters, 91 F. (2d) 61 ..... 28, 32

Kann v. Rosset, 307 Ill. App. 153 23

Knoxville v. Knoxville Water Co., 212 U. S. page 1 16

Lebus v. Stansifer, 154 Ky. 444, 157 S. W. 727 24

Louisville, et al. v. Radford, 295 U. S. 555 27

Luthy v. Ream, 270 Ill. 170 21

Morgan v. United States, 298 U. S. 468, 480 7

Radio Keith Orpheum Corporation, 106 F. (2d) 22 17

Rudolph Wurlitzer Co. v. Commissioner of Internal Revenue, 81 Fed. (2d) 973 25

Sanders Bros. Radio Co. v. Fed. Comm., 106 F. (2d) 321 38

Scripps-Howard Radio Co. v. Fed. Comm., 86 L. Ed. 836 36

S. E. C. v. U. S. Realty, 310 U. S. 434 28

Sutliff v. Aydelott, 373 Ill. 633 23

Swift v. United States, 86 L. Ed. 945 39

Texas v. United States, 292 U. S. 522, 531 29

United States v. Chicago, Milwaukee & St. Paul, 282 U. S. 311 19

United States v. Carolina Freight Com. Corp. (1942) 86 L. Ed. 629 39

United States v. Milwaukee, St. Paul & P. Ry. Co., 294 U. S. 499 38

Western Pacific R. Co. In Re 124 F. (2) 136 35

STATUTES.

Section 77 (11 U. S. C. section 205) 4, 6, 28, 36

TEXTS AND MISCELLANEOUS.

Gerdes on Corporate Reorganization, Vol. 2, Section 187 18

131 I. C. C., page 673 19

Illinois Constitution Art. 11, Section 3 23

CASES DISTINGUISHED.

Florida v. United States, 292 U. S. 1 37

Missouri Pacific Reorganization In Re 39 F. Supp. 436 33

United States v. Louisiana, 290 U. S. 70 37

IN THE

Supreme Court of the United States

OCTOBER TERM, 1942.

IN THE MATTER OF

CHICAGO, MILWAUKEE, ST. PAUL AND PACIFIC RAILROAD COMPANY,

Debtor.

No. 13

GROUP OF INSTITUTIONAL INVESTORS AND MUTUAL SAVINGS BANK GROUP,

Petitioners,

vs.

ISRAEL A. ABRAMS, ET AL.,

Respondents.

No. 32

RECONSTRUCTION FINANCE CORPORATION,

Petitioner,

vs.

CHICAGO, MILWAUKEE, ST. PAUL AND PACIFIC RAILROAD COMPANY, ISRAEL A. ABRAMS, ET AL.,

Respondents.

RESPONDENTS' BRIEF.

THE STATEMENT OF THE CASE.

The Brief of the Institutional Investors and Mutual Savings Bank Group (Case Numbers 11-19) will be referred to as "I. B." and the Brief of the Reconstruction Finance Corporation (Case Number 32) will be referred to as "R. F. C.".

The Statement of the Case in the two Briefs are substantially the same. We deem it necessary to add the facts relating to the Adjustment Mortgage Bonds, which are owned and represented by Respondents.

The Adjustment Mortgage Bonds were issued in exchange for other bonds in the 1928 Equity Reorganization. There are outstanding $182,873,693.00 in principal. The accrued interest from July 1, 1935 to December 31, 1938, is $79,550,055.00. These bonds are secured by a Trust Deed on the entire system of the "Milwaukee", and are secured by a junior lien to the Fifty Year Mortgage of $106,395,096.00 (R. 2166, 2170).

The Adjustment Mortgage Bonds are the only securities whose position is completely changed to that of Common Stock without voting rights. While all other lien creditors receive new securities on the accrued interest to December 1, 1938, these bonds will not receive anything on account of the accrued interest of $79,550,055.00 and the debt of nearly eighty million dollars will be released without any consideration.

Respondents appealed to the Circuit Court of Appeals for the Seventh Circuit (Case No. 7611) and were successful in obtaining a reversal of the approval of the Plan. The opinion did not discuss the points raised there, and it is, therefore, necessary to state the points urged in support of the reversal order which is the subject matter for review. The points are (R. 2005-6):

1. The plan of reorganization does not satisfy the requirement that full compensatory provision be made for security holders in that the Adjustment Mortgage Bondholders were allowed 1,788,655 shares, in common stock of no par value in exchange of a debt of $262,423,748 without a finding that the value of the new securities equaled the value of the securities exchanged.

2. It was necessary and mandatory upon the Commission as well as the court to make findings as to valuation in reducing the capital structure from $860,000,000 to $548,000,000 whereby the Adjustment Mortgage Bondholders were not fully compensated.

3. A plan of reorganization which exchanges secured income bonds for common stock cannot be said to be fair and equitable without a finding as to the valuation of the common stock in order to determine whether the value of the new securities equaled the value of the exchanged securities.

4. A bankruptcy court may not discriminate among secured creditors by allowing interest to one class up to the effective date of the plan and allowing interest to another class up to the date of the filing of the petition, and such a plan is in violation of Section 77.

5. The complete change of the status of the Adjustment Mortgage Bondholders from secured creditors to common stockholders upon the arbitrary allotment of common stock based on capitalization but not on valuation is unfair, inequitable, discriminatory, and deprives such class of their property without due process of law in contravention of the Fifth Amendment.

6. A governmental agency may not adopt a plan to issue common stock, without lodging the ownership of the stock in the persons whose securities are exchanged, and a plan which prevents stockholders from electing directors is unfair, inequitable and in violation of the Illinois Constitution.

7. The surrender of the claim of the Adjustment Mortgage Bondholders on free assets in favor of the senior security holders without any contribution on their part for such surrender is unfair and inequitable and unfairly discriminates in favor of the senior security holders against the Adjustment Mortgage Bondholders.

Disposition of Issues Below.

These issues were presented in the District Court by objections to the plan of reorganization (R. 1382-1384). The court overruled all of the objections (R. 1988). Its reasons for its ruling is contained in its opinion, (R. 1157), which is also published (36 F. Sup., 193). The Circuit Court of Appeals reversed the decision (R. 2297-2317) and its opinion is reported in 124 F. (2) 754.

THE PRIMARY ISSUE PRESENTED.

The primary issue is not whether it was necessary to comply with "a technical requirement" or "a formal finding" (I. B. p. 29), or that the "reasons and conclusions" of the Commission "be labeled as findings" (R. F. C. p. 13), but whether under §77 (e) requiring a "*determination*" of value if "*necessary*" for "**any purpose**", it was mandatory upon the Commission *to determine* (1) *the value* of the whole of the Debtor's estate, and (2) the value of the common shares to be given in exchange for the Adjustment Bonds, under the plan which did not make the Bondholders "whole", but which allowed 1,788,655 shares of common stock of a *stated value of* $100 for each share (without a determination of *actual value*) in exchange for Principal Bonds of $182,873,693.00 and without allowing anything on account of the accrued interest of $79,550,055.00.

The Court of Appeals held that *under such a plan* it was "necessary" (1) to determine the value of the whole estate of the debtor and (2) the value of the new common stock in order to enable it to pass on the fairness of the plan. It remanded the case for such a determination.

The primary question is, therefore, the construction of the word "necessary" under §77. Is the word "necessary" to be determined by the nature of the plan and the applicable legal principles concerning a plan which provides for the allocation of new securities in exchange of existing securities as held by the Court of Appeals, or is it to be determined by the *whim* of the Commission as to what is practicable or necessary regardless of the plan, as advocated by the Petitioners.

The Court of Appeals (contrary to the contention of the Petitioners) did *not* base its reason on "technical requirements" or "formalism", but on the *substantive* rights. It placed the "primary issue" in the following words (R. 2313):

> "In the report of the Commission there is a **discussion of the various factors** which were deemed pertinent in its inquiry into values. **Absent, however, were clear cut findings or values** which are so essential to the intelligent approval of the plan."

It made the primary question clear when it stated:

> "Our criticism is **not directed to the fact that the findings were embodied in the Commission's** report (a large part of which is devoted to a discussion and statement of the evidence) **rather than stated specifically as findings. But the fault lies in the fact that we are left uncertain, or in the dark, as to the finding of the Commission. The evidence might support a finding of a larger or a smaller amount.** Which should we accept? The fact finding body is the I. C. C. It must find. We cannot." (Emphasis ours.)

The Ninth Circuit, in rejecting the plan in the *Western Pacific Railroad Reorganization*, 124 F. (2) 136, also placed primary issue on the construction of the word "necessary" under §77 (e), and concluded that where creditors are not made "whole" and are required to accept new securities in exchange for the existing securities, it is *necessary* to determine the value of the whole estate, as well as the relative value of the securities. **The construction of the word "necessary" in relation to the plan is the vital issue in this appeal.**

ARGUMENT.

A.

The Decision of the Court of Appeals That the Plan Cannot Be Approved in the Absence of a Determination As to the Value of the Whole Estate and the Value of the New Common Stock Given in Exchange for the Adjustment Mortgage Bonds Is Correct and Should Be Affirmed.

The Court of Appeals reversed the order approving the plans as to the respondents without discussing any of the points relied on for reversal. It is therefore necessary to discuss such point in order to show that the decision is free from error and should be sustained.

I. The change of the position of the Adjustment Mortgage Bondholders from secured creditors to common stockholders without voting rights upon the arbitrary allotment of 1,788,655 shares, without determination of their value, made the plan discriminatory, unfair, inequitable, and in violation of the Fifth Amendment and the Court of Appeals properly reversed the approval of such a plan.

Respondents contend that in the absence of a *finding* or *determination* that the value of the mortgaged premises was insufficient security for the Adjustment Mortgage Bonds, the Commission was in no position to approve a plan which called for the release of the mortgage lien (*Re Chicago, R. I. & P. Ry. Co.*, 90 F. (2) 312; *a fortiori, Morgan* v. *United States*, 298 U. S. 468, 480); here, where

there was a finding that *there was a large equity in excess of the debt of the senior securities* (R. 2164), the release of the entire mortgage lien is not justifiable under any theory.

(a) An exchange of bonds for stock must be fully compensatory and the No Par Value Stock at a stated value but of no actual value did not afford such compensation.

Having decided to approve a plan which relegated the bondholders of this class to the position of common stockholders without voting rights, the Commission and the District Court should have at least fully compensated the existing debt in excess of $262,000,000.00 with stock of *equal value*, under the rule that *an exchange of securities must be of "full compensatory" value* (*Consolidated Rock Products Co.*, 312 U. S. 510). The allowance of common stock of 1,788,655 shares of no par value at a *stated value* of $100 for each share *without a "finding"* of "determination" of the *real value*, did not meet the requirements of law for an exchange of securities. The Commission's Examiner recommended the issuance of new stock on the ratio of 14.3 shares for each $1,000.00 bond (R. 1226). Even the Institutional Groups recommended the issuance of common stock for the *full debt.** The Commission *arbitrarily* curtailed this allotment.

The reason given by the Commission for not following the recommendation of the *"Institutional Groups"* or of the Debtor is based on the *capitalization*, and *not* on the *valuation*. It arbitrarily fixed a capitalization of $548,533,321.00 and within such "frame" it allowed to this secured class and general creditors whatever balance

* The Petitioners' plan allotted 2,578,000 shares instead of 1,788,655 which are allowed under the plan which they now claim to be fair and equitable (R. 820).

was left after distributing "securities" to holders of senior securities. This appears from its Report (R. 2256-7):

> "After the provision hereinafter made for the allotment of 35,625 shares of new common stock to the Gary bondholders, **there remains for distribution to the Adjustment-Mortgage Bondholders and to the unsecured creditors 1,804,492 shares of new common stock.** We hereinafter set aside 55,000 shares of common stock as representing a fair proportion of the equity of the new company for the unmortgaged assets of the debtor. **Thus there will remain 1,749,492 shares for distribution to the Adjustment-Mortgage Bondholders for their claim upon the mortgaged assets of the debtor.** Since the principal of this claim and interest to June 29, 1935, the date of filing of the petition, amount to $230,420,853, **it is evident that the above allotment of stock, taken at $100 a share, will fail to satisfy the claim by $55,471,653. For this portion of their claim, these bondholders should be permitted to participate with other unsecured creditors in the free assets of the debtor.** In view of the insufficiency of proceeds of mortgaged assets to meet the claims of the Adjustment Bondholders and the apparent inadequacy of the free assets to satisfy the deficiency, with interest, we find that no allowance should be made in the plan for interest on these obligations for the period subsequent to the date of filing of the petition." (Emphasis ours.)

The fallacy of this reasoning is apparent. If the *stated* value of $100 per share was *actual* value, there would be some logic to the position. The Commission, however, *made no finding as to actual value of these shares.* Neither the Commission nor the District Court could say what was in store for the Adjustment Mortgage Bondholders, as the new common stock was also allotted to the Fifty Year Mortgage to the "Gary Bondholders".

and to the *general* creditors, and *there was no determination what the stock was actually worth.* In this connection it might be interesting to examine the statement of one of the Petitioners (the chairman of the proponents of the present plan), who said (R. 793):

> "I think the no par common stock which is given in satisfaction of the claims of the adjustment, present adjustment bondholders has *some prospective value.* That value is at the moment *highly speculative.*"

He further said (page 795):

> "**As to what value the no par stock has at the reorganization, that depends upon what the actual situation is then.**" (Emphasis ours.)

The cancellation of the secured debt in excess of $262,000,000.00 in exchange for common stock *without any definite value* and the participation in the common stock by other creditors *on the arbitrary assumption that the deficiency of the Adjustment Mortgage Bondholders will* be $55,000,000.00, could not be sustained, and the Court of Appeals properly reversed the approval of such a plan.

The allotment of common stock of a stated value of $178,863,500.00 cannot be justified on any theory. If the Adjustment Mortgage Bondholders were allotted the entire common stock, then, of course, it would have made very little difference whether or not the capitalization was based on actual value or on a mere arbitrary amount, as the Adjustment Mortgage Bondholders would have then received in common stock the entire equity left for them, and their equity above the debt of $364,000,00.00 would not have been diminished. **The situation, however, is different under the plan when they become partners in the equity with general creditors and with secured creditors who will also receive common stock.** Under such a

plan the Adjustment Mortgage Bondholders were entitled to receive new securities for the full value of their old securities. *The taking away of their property for the benefit of other creditors could not be sanctioned under the law.* (*Ginsberg* v. *Lindell*, 107 F. (2d) 721.) Property of one creditor may not be given to another creditor in reorganization proceedings under the Bankruptcy Law. *Case* v. *Los Angeles Lumber Products Co.*, 308 U. S. 106. *The release of the vested rights of the Adjustment Mortgage bonds without due compensation is prohibited* by the Fifth Amendment *even* under Bankruptcy power under 77 (*Re Chicago R. I. & P. Ry. Co.*, 90 F. (2) 312, and the Court of Appeals properly rejected such a plan.

(b) The Valuation Is in Excess of the Capitalization.

Even if it be conceded that valuation and capitalization are synonymous, it should not be overlooked that the petitioners *had previously consented to a capitalization of* $753,551,449. **Up to September 20, 1937, they urged upon the Commission the approval of a plan which was based on such capitalization. This capitalization was based on the physical valuation, the actual earning and the forecast of the earnings for the future normal year.*** The physical value did not change from September 20, 1937 to January 10, 1938, when the Institutional Groups presented their new plan, and when the other Petitioner (R. F. C.) gave it its support. The President of the road, one of the trustees, testified in June, 1936 (R. 554) that Exhibit 96 which was introduced in evidence in 1935 was a mere estimate or "fore-

* It is noteworthy that the petitioner who offered evidence as to the valuation of the whole estate of the Debtor when they sought the approval of their plan (R. 724-726) now urge in support of this plan that it is impossible to determine the value of a railroad (I. B. p. 48, R. F. C. p. 33).

cast" of gross net revenues under the proposed plan for the years 1936-1940, but the *actual results* of operations for the last half of the year 1935 and the year 1936 *showed revenues in excess of* $12,425,543 *over the forecast.* He said that while operating expenses were higher, the "net income was $6,539,737 higher." Instead of a forecast of a deficit of $2,833,185 shown in Exhibit 96 the *actual operations show an increase of* $4,117,761, so that the total *net income was increased by* $6,950,946. He testified that the Debtor's property, including equipment, was "in good shape" and that no special rehabilitation fund was necessary. At the June hearing in 1937, Mr. Burgess, counsel for the Institutional Groups, (the Petitioners) in supporting the Debtor's plan for a capitalization of $753,551,449 said (R. 629):

> "At the initial hearing before this Commission, in this proceeding, the Debtor submitted a plan of reorganization. *The position of the Bondholders Group was that the plan constituted a fair and feasible standby arrangement for a period of economic adjustment.*"

He further said (page 630):

> "Exhibit 120 introduced in evidence this morning shows that *the actual operations* during the period January 1, 1937, *were more favorable to the operation of the plan than contemplated* when it was originally introduced. * * * We are therefore still willing to acquiesce in the plan as a vehicle of prompt reorganization at this time."

He also said:

> "We would further like at this time to have the record show that **in the opinion of our committee, whose chairman has made a personal inspection of the Debtor's line, the operation of the property by the trustees under the direction of the court, has been such as adequately to protect the public interest, and that during the trusteeship the physical condition of the property has been improved.**" (Emphasis ours.)

It is evident therefrom that the reduction in capitalization from $753,551,449, sponsored by the petitioners, to a capitalization of $548,533,321 **was not due to any decrease in physical value nor in actual revenues obtained.** At the hearing on September 29, 1937, a delay was sought by the Debtor. The president of the road referred to Exhibit 121 which was received in evidence at the previous hearing as a "forecast" for the years 1937 to 1941. He said that the *actual earnings* for the seven months ending July 1, 1937 were increased by 1.8% (R. 639). The net was increased by $1,819,630.87. After showing the *actual operations* of the road, *it proved better than the forecast.* The chairman of the Institutional Groups and its "expert" witness, Mr. Walker, testified in September, 1937 (R. 674) that the Institutional Groups had "*carefully followed the earnings and operating expenses*"; that he made a *personal* inspection of the Debtor's property; that the actual operations of the road showed *a marked improvement* (R. 684), and he had no reason to feel that the 1935 plan was not going to work out, but that a change has now occurred by the statement of the Debtor (page 685) that there will be an increase in operating expenses, and *therefore he desired the postponement so that a new plan may be presented.* On January 7, 1938, the Institutional Groups adopted their new plan reducing the capital structure from their proposed plan in excess of $753,000,000 to their proposed plan of $640,000,000. **Neither the physical value nor the actual operations changed to such an extent from September 20, 1937 to January 7, 1938, to justify such a reduction in capital structure, particularly if capitalization be deemed valuation.** He, Mr. Walker, also appeared as an "expert" at the hearing in February, 1938. He then testified in support of the Institutional Groups' plan (R. 724):

> "In order to provide a sound financial structure, restore the credit of the enterprise and permit necessary new financing, the capitalization should not exceed a conservative valuation of the assets to be taken over by the reorganized company".

He also said under oath (page 726):

> "The Committee believes that the present operating management of the Debtor has been efficient, the properties are in good condition, have little deferred maintenance and will require only normal expenditures of capital account. * * * It is believed that the cash position will be such that the reorganized company will have adequate working capital after absorbing the expenses of reorganization. Therefore, it is concluded that no new money will be needed in the reorganization."

His testimony was that the capitalization should be based on the conservative valuation. His capitalization was $640,000,000, sufficient to pay the full amount of the debt of the Adjustment Mortgage Bondholders. In explaining the reduction of the capitalization from $849,876,000 to $640,687,000 he said that *he gave consideration to the value of the assets* (R. 740), *taking the valuation as to physical value that of the Bureau of Valuation,* **in the light of the prospective earnings.** The valuation therefore of this "expert" and proponent of the present plan *is at least* $640,000,000. He said that *his plan was predicated on what he believed to be the fair and equitable relative value of this system.** This is about the only testimony on which the petitioners can rely. *His testimony shows a valuation of* $640,000,000. Sufficient to pay the debt of the Adjustment Mortgage Bond in full in the form of the new securities.

* Now he says through the mouth of his counsel that such a valuation was impossible.

II. The plan which allowed new securities on account of accrued interest to all other security holders up to December 31, 1938, and did not allow any new securities on account of the accrued interest of approximately $80,000,000 on the Adjustment Mortgage Bonds unfairly discriminated against them in violation of Section 77.

The Commission adopted two measures of justice in treating the secured creditors. The senior creditors were allowed new securities on the accrued interest up to December 31, 1938, while no new securities were allowed to the adjustment mortgage bondholders for the accrued interest during the same period amounting to approximately $80,000,000. *There is no justification for the scale of justice meted out by the Commission which was approved by the District Court.* While the Circuit Court of Appeals said nothing in its opinion when it reversed the approval of the plan, yet we are entitled to urge every reason in support of the reversal order.

(a) The Adjustment Mortgage Bondholders were entitled to new securities in payment of the accrued interest to the same extent as the senior securities in the absence of a finding that the estate of the Debtor was insufficient to pay such interest.

The Institutional Groups who now say that the plan is fair and equitable and is not discriminatory, had a different view before the Commission. In answer to a question by the writer, *the Chairman of this Group stated that the public interest required that all deferred and defaulted interest on the debt up to the time the reorganization plan is made effective shall be recognized with the principal of the debt including their interest on the Junior Securities* (R. 811-812). The District Court recog-

nized this principle (R. 1871), which was also reiterated by this Court in the *Consolidated Products* case (312 U. S. 510). *No such treatment was accorded this class of secured creditors.* If there were findings by the Commission that the debtor's estate was insufficient to pay such interest there might be some justification. In the absence, however, of any findings as to the value of the debtor's estate, the disallowance of new securities for the accrued debt of approximately $80,000,000 cannot be justified. The Circuit Court of Appeals was, therefore, correct in reversing the approval of the plan for a lack of findings. The only pretense for alleged findings as to the value of the debtor's estate is the capitalization. *Capitalization* is not synonymous with *valuation* (*Knoxville v. Knoxville Water Co.*, 212 U. S. 1, 11), particularly when the capitalization includes *no par value stock without a finding as to the real value.* It was improper to build a frame and thereafter say that the body did not fit the frame.

III. Even if it was proper to change the position of the Adjustment Mortgage Bondholders to that of stockholders, it was improper to deprive them of their voting rights.

The adjustment mortgage bonds were previously exchanged for other bonds in the former reorganization plan. By that plan they were placed in the lowest class in respect to their lien. Their security was diminished by exchanging the definite interest payments to payments from income, if any. **$80,000,000 in such interest remained unpaid.** Under the present plan their rights will be further lowered by the exchange of their secured creditors' position to the position of common stockholders, *without voting rights.* The present plan will place this class in the same category as the existing preferred and common stockholders who find themselves in the position of being completely wiped out.

(a) A plan which is approved by a court in advance of the approval by the creditors must be the best plan obtainable.

A plan under §77 is different from a plan under §77-B. In the latter, creditors agree in advance on the plan and the court is merely called upon to approve the action of the creditors. In such a situation it is not the duty of the court to say that the plan is the best plan. The court may be guided by the desires of the creditors and as long as the plan is fair and reasonable it may approve such a plan (*Radio Keith Orpheum Corporation*, 106 F. (2d) 22). This is completely different under §77, which requires the Commission, a governmental administrative body, and the court, **to send out the plan to the investors with their stamp of approval, thereby inducing the creditors to vote in favor of the plan.** Such a plan must not only be fair and reasonable *but the best plan obtainable.*

(b) A plan which compels secured creditors to become common stockholders without the right to manage the property is not only not the best plan but is unfair and inequitable.

The difference between a secured or general creditor and a stockholder was well pointed out by the 9th Circuit in Consolidated Rock Products Co., *supra*, 114 F. (2d) 102, where it was said:

> "When a person **buys a bond**, he obtains it on the theory that he is not an owner **but a creditor.** When a person **buys stock**, common or preferred, he knows that he buys an interest in the company which is subordinate to claims of corporate creditors. *He runs the risk of having an interest in something that is valueless.*" (Emphasis ours.)

In Gerdes on Corporate Reorganization the court says (Vol. 2, Section 187):

> "It must be remembered that a creditor has a right to proceed at any time after the debt matures, or after interest is due, against the property of the debtor, but a stockholder has no such right. * * * When these, and other similar considerations, are waived, **it may very well be that the change from the status of creditor to that of stockholders * * * will be found to be unfair,** even though the priority of rank is preserved." (Emphasis ours.)

While an investor has the right to *risk* his investment and acquire common stock in a corporation at the danger of being completely wiped out by the creditors, **neither a Commission nor a court should force investors to undergo such risks by exchanging their secured creditors' position as well as their general creditors' position to that of common stockholders.*** If in the ordinary reorganization this may be considered fair and equitable when the large majority of creditors decide to make the change, *no governmental agency and no court should stamp such a scheme with their approval and influence creditors to accept such a plan,* as would be the case here.

The Plan contemplaes the allowance to the senior securities control of the management by the selection of four out of five voting trustees. The Adjustment Mortgage Bondholders who now have about *35 per cent of the total debt* are to release their secured and general creditors' position. They will become holders of common stock *subjecting themselves to the risk of being completely wiped out in the event of a default or future reorganization and deprived of the management of the property.* If they are to become "owners" instead of "creditors" *they should at least have the right to manage.* In passing upon the

* This is not in the "Public Interest" which is required under section 77.

management under the former reorganization plan the Interstate Commerce Commission said in its report (131 I. C. C. p. 673):

> "That as **a general rule power to control corporation management should rest in owners of share capital rather than in those who occupy a position of creditor** and that the owners of share capital should thereunder exercise this control periodically and at reasonably frequent intervals, is commonly regarded as a sound principle. **Any proposals which would result in a more or less complete alienation of such power** over an extended period of time **by its lodgment** either with creditors or **with an individual or small group** of individuals can be justified only **by demonstration of facts of special application and sufficient weight to warrant us in departing from the rule.** In the instant case the proposals above recited, involving, as they do, **compulsory alienation of complete voting power from shareholders** for a period of *two years only*, after which shareholders may resume this power, may be regarded as not unreasonable in view of the facts. The purpose of the proposed voting trust is stated to be the initial provision of capable management for the reorganized property." (Emphasis ours.)

Under the instant Plan the common stockholders will be deprived of management for a period of *five years*, and *there is no evidence in the record to justify such a treatment*. It is true that in the instant case instead of committees there are Institutional Groups who sponsor the new Plan, but *this is merely a change in name* and it may be apropos to quote from the dissenting opinion on the approval of the former reorganization case by Mr. Justice Stone (282 U. S. 311):

> "The history of the receivership resulting in the present reorganization will be found in the report of the Commission in the *Chicago, Milwaukee & St. Paul Investigation*, 131 I. C. C. 615, issued the same day

as its report in the present case. The old company having reached the end of its financial rope, and protective committees representing respectively the bondholders, the preferred, and the common stockholders having been organized, its bankers, the present reorganization managers, were active in bringing about the receivership and have since dominated the reorganization. The Commission said (pp. 667, 668):

"'For months prior to the receivership they (the railroad's directors) were impotent. It was an ideal situation for the bankers to control. This they promptly did, arranged all the details, framed up the committees favorably to themselves, put themselves on the bondholders' protective committee and constituted themselves reorganization managers.'

"As managers they formulated the reorganization plan, and incorporated it in an agreement between themselves and the committees. In every practical sense the reorganization managers controlled the foreclosure proceedings resulting in the sale of the property of the old company. Their representatives were the purchasers at the foreclosure sale. They created and controlled the new company, which is the appellee here. The reorganization plan gave them full power to modify it as a whole or in detail, with the approval of the committee representing the securities affected. They were authorized to carry out the plan; and in doing so they were empowered to act for, and as intermediaries between, the committees, the stockholders, and the new company."

The evidence in this case adduced by the cross-examination of the writer shows that *prior to the filing of the present reorganization, the Debtor and the Institutional Groups worked out a reorganization which they now admit not to have been feasible and equitable* (R. 401-428). While they said that they changed their position because of increased expenses and revenues which were not anticipated, they have not changed their position from

keeping the control of the railroad through a voting trust. Their prearranged plan even contemplated the *personnel of the trustees under the voting trust* (R. 407, 408). The Commission did not approve the voting trust idea in its original report of February 12, 1940. The Debtor which first sponsored the voting trust idea, *when it worked hand in hand with the Institutional Group,* thereafter *opposed it* when their interest became *adverse*. The Commission, in passing on this question, said (R. 2264):

> "In our opinion the necessity for a voting trust for the new stock has not been demonstrated and we think that the interest of the security holders will be safeguarded if the debtor's proposals with respect to the manner of electing the new Board of Directors and with respect to the voting rights of the stockholders are followed."

It changed its opinion in the final plan (R. 1295). The Commission stated:

> "Reconsideration of the matter of the need for a voting trust in the light of the Committee's petitions leads us to the conclusion that such a voting trust would be desirable, in order to insure continuity of managerial policy, protection to bondholders, a proper maintenance of the property, all of which are in the public interest."

That it is not in the public interest to take away the rights of stockholders to vote is well settled.

(c) While a voluntary voting trust may be created it is against the public interest to create such an involuntary trust and to deprive stockholders of their rights.

In *Luthy* v. *Ream* (270 Ill. 170), the court quoted from Shepaug Voting Trust Cases (60 Conn. 576), the following:

> "It is the policy of our law that an untrammeled power to vote shall be incident to the ownership of

> the stock, and the contract by which the real owner's power is hampered by a provision therein that he shall vote just as somebody else dictates is objectionable."

On page 182 the court referred to several cases which held that an agreement among stockholders to place their stock in the hands of trustees for a limited number of years to enable the trustees to manage the corporation constituted a valid trust. The court said:

> "These cases are inconsistent with the views which we have expressed and the cases cited in support of them, but in our judgment the latter cases state the true rule."

The question of the validity of a trust agreement was later presented to the Supreme Court of Illinois in *Babcock* v. *Chicago Railways Co.*, 325 Ill. 16, where the validity of the trust was sustained. The court, however, distinguished the *Babcock* case from the *Luthy* case on the ground that in the *Babcock* case the trustees had an interest in the stock beside the right to vote it. The trustees there had "the legal title to the stock for the benefit not only of the appellants and the other assenting and depositing holders of participation certificates, but for all the persons, corporations, trustees, bondholders, mortgagees, and for the City of Chicago." The court pointed out that the trust "was made to protect the rights not olny of the holders of the participation certificates, but of all other interested parties to the transaction." It should also be remembered that **in the Babcock case the bondholders had previously voluntarily deposited their bonds under a deposit agreement whereby they parted with their equitable and legal title to the bonds** and obtained beneficial certificates as part of a voluntary reorganization plan in consideration whereof an ordinance was passed and a reorganization

was approved whereby new capital was invested. The persons who voluntarily surrendered their rights and consented to the terms were held not to be in position to question the validity of the agreement particularly after they have vested the ownership of the stock in the trustees. An action by a person, who, for a valid consideration, parts with his legal and equitable title and vested such rights in a trustee, is distinguishable from the case where a person did not consent thereto assails the validity of such a trust (*Felt et al.* v. *U. S. Mortgage and Trust Company*, 231 Ill. App. 110). The last decision of the Illinois Supreme Court on this subject is to be found in *Sutliff* v. *Aydelott*, 373 Ill. 633, where the court again distinguished the *Luthy* case on the ground that there "owners of all the stock put it into a voting trust and a person not the owner was given all the voting rights", while in the *Sutliff* case "the title to the stock is vested in trustees and they, as owners, have the right to vote it." *It is evident from the foregoing that the Illinois law is clear that where the ownership of the stock remains in the stockholders a voting trust which deprives stockholders of their right to elect directors, is void.* The question was also presented in *Kann* v. *Rosset*, 307 Ill. App. 153, and in answer to the point that the voting trust agreement contravenes and violates Section 3 of Article 11 of the Constitution of the State of Illinois, the court said that inasmuch as the voting trust placed the ownership of the stock in trustees, therefore, the trustees were the stockholders and there was no constitutional violation.

In order to add validity to the trust it will be necessary to have the shares issued in the name of the trustees in order to make them "owners" of the stock and to issue beneficial certificates to the Adjustment Bondholders. A bankruptcy court has no power to take the shares from

their owners and transfer them to anyone else, whether for consideration or not. A voting trust must be **voluntary.** This was quarely held in *Lebus* v. *Stansifer,* 154 Ky. 444, 157 S. W. 727). There, it was said (p. 450):

> "Independent of any constitutional or statutory provision, in the absence of the consent of such stockholders, such a provision cannot be upheld. The right to control one's own property is inherent; **and while the courts have upheld voting trusts** and pooling arrangements by stockholders where they are made with full knowledge of all the conditions, and are designed to effectuate some common purpose for the common good and have been **voluntarily entered** into, we are **aware of no instance** where individual rights have been so far abridged as to hold **that a stockholders' shares may without his consent be placed in such a trust** either by a charter provision or otherwise, and be deprived completely of their control, even upon the ground that it was for his own as well as for the general good. **It is well grounded in our fundamental law that there is no limitation upon one's right to control that which is his own,** except such restrictions as might be imposed by the law of the land. Any other rule would be subversive of that individual responsibility which is the key-note of all civilization and progress. To say that appellants may without the consent of the poolers have inserted in the articles of incorporation a clause taking from the poolers the right to control that which is theirs, and place its control absolutely in their own hands, would be to recognize a most unwarranted assumption of authority. **There is no more sacred duty confided to the courts than the upholding of individual rights in property,** and no considerations of temporary advantage which it is thought might accrue to the owners generally, will justify them in departing from the well beaten paths so clearly defined in all English and American jurisprudence." (Bold type supplied.)

(d) The creation of the voting trust is in violation of the Illinois Constitution.

The Illinois law was construed by the Federal courts in *Rudolph Wurlitzer Co.* v. *Commissioner of Internal Revenue,* 81 Fed. (2d) 973, and it was there held that under the Illinois law stockholders may not be deprived nor may they not deprive themselves of their rights to elect directors. If the Commission had determined as part of the plan that the Adjustment Mortgage Bondholders be deprived of their ownership of the no par common stock which is given to them in exchange for their bonds and that the new stock belonged to some other person, there may be some possible theory under which the validity of the trust may be founded. If the Adjustment Bondholders (after the reorganization plan became effective) voluntarily parted with the ownership of the bonds and placed the legal ownership thereof in trustees coupled with the interest, there may be some force to the argument that the trust was valid. **No one here will contend that a plan of reorganization may be approved which would on the one hand compensate bondholders with common stock and at the same time declare them not to be the owners of the new stock. There is no finding by the Commission that such a plan would be fair and equitable nor did the court make any such finding.** The purpose of the trust as stated by the Commission is not to deprive the stockholders of the ownership of the stock **but to control the election of the directors and the management.** This is the thing which is **prohibited by the Illinois Constitution and by the decisions thereunder.** Even if such a trust were not illegal, it is unfair and inequitable for a Commission and a court to recommend to bondholders to receive stock in exchange of their bonds and to deprive them at the same time of ownership of the new securities. **While investors may become parties**

to corporate enterprises whereby they are deprived of a vote and such corporate structure may not be illegal, it is certainly inequitable to coerce creditors to give up their creditors' position to become stockholders without a right to vote. The purpose of reorganizations under bankruptcy law is to lodge the operation or management in the owners or stockholders. All that a creditor is entitled to is security for his debt, but he is not entitled to take over the debtor's business. Under the new corporate setup there is no question of the adequacy of the protection to the senior security holders. There is no reason therefore why the Commission and the court shall put out a plan depriving the persons, who are surrendering a debt of thirty-five per cent of the total liabilities of the reorganized company for common stock, from the management of the reorganized property. The reversal of the approval of such a plan was therefore proper.

IV. The surrender of the claim of the Adjustment Mortgage Bondholders as creditors on the free assets in favor of the senior securities who will remain the only creditors, discriminated inequitably in favor of the senior creditors and the debtor in violation of the Act.

The Interstate Commerce Commission recognized in its report that the Debtor is possessed of free assets which are not subject to any liens. It has allotted for these free assets 55,000 shares in common stock to the Adjustment Mortgage Bondholders and to general creditors. While it is our position that the free assets exceed the estimated amount of the Commission, particularly in view of the fact that the Debtor was possessed of $10,000,000 cash in addition to the other free assets, yet, even on

the amount as estimated by the Commission the Adjustment Mortgage Bondholders *are surrendering their creditors' position on the free assets in favor of the senior creditors* who, in the event of any default, will be able to appropriate *all the free assets for their claims to the extinguishment of the Adjustment Mortgage Bondholders who will then be stockholders.*

(a) Section 77 does not authorize the taking away of the claim of one creditor in favor of another creditor.

While §77 authorizes a change or alteration in the class of securities *it does not authorize the approval of a Plan which takes away rights from one class and gives it to another class without consideration.* The taking away of such rights without compensation deprives such class of creditors of due process of law, and *even the Bankruptcy Act is subject to the prohibition of the Fifth Amendment in that respect.* (*Louisville, et al.* v. *Radford*, 295 U. S. 555.).

The Plan which deprives the Adjustment Bondholders of their claims as creditors against the equities in the mortgaged premises and in the free assets discriminates against them in favor of the senior secured creditors and in favor of the Debtor and is contrary to the requirements of the "law of the land" as announced in the *Boyd* case, 228 U. S. 482, which rule was applied to reorganizations in bankruptcy in *Case* v. *Los Angeles Lumber Products Co.*, 308 U. S. 106.

In *Jamieson* v. *Watters*, 91 Fed. (2d) 61, the court said (page 64):

> "Whether the plan is fair to general creditors is thus seen to depend on two factors which can be but have not been heretofore determined; one, what

amount of the unpaid bond interest is secured by the present mortgage at the fair valuation of the property covered thereby, and two, *what is the fair value of the free assets.*"

The court held that the general creditors were entitled to their share in the free assets.

This applies with equal force here. The taking away of the free assets from the creditors and the gift thereof to the "senior creditors" who will have the only claim thereon, is in violation of the "familiar rule" as applied to bankruptcy reorganizations. (*Case* v. *Los Angeles Lumber Co.*, 308 U. S. 106.) In *S. E. C.* v. *U. S. Realty*, 310 U. S. 434, 84 L. Ed. 966, this Court said that "any scaling down of the claims of creditors without some fair compensating advantage to them" is not in conformity with the rule in the *Boyd* case as applied in bankruptcy reorganizations. *Certainly the extinguishment of the entire claim in favor of secured creditors is not within the rule.*

(b) The plan which wipes out all stockholders and relegates the position of the Adjustment Mortgage Bondholders to stockholders who may be wiped out is not compatible with the public interest.

Section 77 (d) requires, before the Plan of Reorganization can be approved, that the Court must find that the provisions of the Plan are fair and equitable; that such provisions do not discriminate unfairly in favor of any class of creditors or stockholders, and what is more important, **it must be compatible with public interest.** Great emphasis was made by the petitioners (I. B. pp. 39-40) on the "Public Interest." **A Plan which wipes out preferred and common stockholders and which places secured creditors in the category of common stockholders**

who may be wiped out in the next reorganization is not compatible with public interest. The "public interest" is in "aid to protect interests of creditors" and not to defeat them. (*First National Bank* v. *Flershem*, 290 U. S. 504, 515). It is necessary for the maintenance of railroads that the investors invest their money in securities offered on the market by railroads. Investors who invest their money in securities must feel safe that their securities will not be changed into stock, and **a Plan which enables the exchange of "Bonds" for "Stock" will disrupt the confidence of the public in the purchase of railroad securities.** The creation of such a state of mind in the investors will not be for the public interest. The criteria to be applied to the term "public interest" is not a mere general reference to "public welfare" but to appropriate provision and best use of transportation facilities (*Texas* v. *United States*, 292 U. S. 522, 531). The moneys invested to furnish the physical properties used in the service of the public will be withheld, and a Plan which tends in such directions cannot be regarded to be in the public interest. An important element of "public interest" is the ability of the railroad "to render the best practicable service" to the public and its "financial qualification to operate" (*Commission* v. *Sanders Radio Station*, 309 U. S. 470, 475). **A plan which will prevent the public to purchase securities will effect the financial qualifications of the railroad to operate in the best interest of the public.**

B.

The Contentions of the Petitioners That the Court of Appeals Erred in Reversing the Approval of the Plan in Remanding the Case for a Determination As to Value, Are Devoid of Merit.

We will now discuss the contentions of the petitioners who desire the reversal of the order of the Court of Appeals and will demonstrate that there is no merit to any of the contentions. We will attempt to follow the Brief of the Institutional Groups in the chronological order and will refer occasionally to the Brief of the R. F. C. when necessary.

I. The decision below did not misconceive the purpose of Congress in enacting Section 77 and it does not render that statute ineffective.

It is contended (I. B. p. 22) that the Court of Appeals misconceived the purpose of §77 and that its order rendered the Statute "ineffective". The word "impracticable" is substituted for the word "ineffective" by the other petitioner (R. F. C. p. 27) but the argument is the same.

Under (a), the "background" leading up to the enactment of §77 in 1933 and its amendment in 1935 is well stated (I. B. pp. 22-29; R. F. C. pp. 17-22). We have no quarrel with the statement under the heading "The Historic and Statutory Background".

Under (b) it is urged (I. B. pp. 29-30) that the decision held that while "the evidence of record was adequate to support the plan" it interpreted this Court's decision in the *Consolidated Rock Products case* (312 U. S. 510) as "requiring other and additional findings, different from

those made by the Commission", to permit a review. Because of such interpretation they claim that the decision "would nullify the new legislation" and make it "ineffective", or "impracticable". They say (I. B. p. 30; R. F. C. pp. 27-28) that Congress had *plainly* "defined the kind of report which it intended the Commission to make", in which the "Commission shall state fully the reasons for its conclusion". We will show that there is no merit to the argument.

(a) The requirement of Section 77 that the Commission shall state its reason for its conclusion applies to a report refusing to approve a plan, and is inapplicable to a report approving a plan where findings are expressly required.

The argument (I. B. pp. 30-32; R. F. C. p. 28) that "findings" or a "determination" as to value is *unnecessary* because Congress only required that the Commission state "fully the reason for its conclusion" *is built on false premises.* The Commission is required to give "reasons" for its **"refusal"** to approve a plan (App. iii). The act calls for "findings" or "determination" upon the **approval** of a plan (App. vii) stating: "If it shall be necessary to determine the value" of the property **"for any purpose"** the Commission **"shall determine such value"**. Here, **not "reasons", not "conclusions", but a "determination" of "value" is required.**

(b) Findings as to value are necessary when a plan proposes the exchange of securities and creditors are not made "whole".

The Act expressly provides for a *determination of value* when such determination became *necessary for any purpose.* The question is, therefore, not *whether* findings are necessary, but *when* the findings are necessary. The neces-

sity depends on the *nature of the plan*, and does not depend on the question whether it is "practicable" or "convenient" as claimed by Petitioners (I. B. p. 48) and as held by the Commission in another case on which Petitioners rely (252 I. C. C. 325, 361). The question whether the findings become *necessary can only be answered by the proposed plan*. The word "necessary" is to be governed by the *plan* and not by the procedure.

(c) When a plan contemplates to give only partial consideration to a class of creditors the valuation becomes necessary as a matter of law.

If a plan contemplates to satisfy all creditors in full and does not propose to wipe out stockholders, it is obvious that it is not necessary to have a valuation as it is of no importance to the creditors what the valuation is, as long as they are compensated in *full* of their claim. When a plan, however, proposes to *partially* satisfy the creditors **there must be a "finding"** that the assets are insufficient to satisfy the balance of the claims as otherwise it would amount to a confiscation of the property. *This can only be done by valuation of the property and a "finding" as to such valuation.*

In *Jamieson* v. *Watters*, 4th Cir., 91 F. (2) 61, the Court considered the question whether a "finding" as to "valuation" was necessary in passing upon the "fairness" of a plan. It said (page 63):

> "The answer depends on definite findings as to certain facts which were not determined by the District Court and cannot be determined by the record in this case."

The Court concluded:

> "We do not intend by these illustrations to suggest any particular ratio of division between the two in-

terests as fair and equitable but only to point out that **until findings have been made as to the value of the mortgaged assets and the free assets respectively it is not possible to determine what division would be fair,** and on the record as presented it does not affirmatively appear that the ratio in the plan is fair." Boldface supplied.)

The Institutional Groups dispute that the decision of this Court in *Consolidated Rock Products* case (312 U. S. 510), is authority for the proposition that it was necessary for the Commission and the Court to make findings as to valuation. They say that this Court merely held that "data" was necessary and not "findings". It is true that the Court held (p. 520) that *data* was essential as a basis for a finding of valuation. It did not hold, however, that findings were unnecessary. On the contrary, it said that "*there must be a determination* of what assets are subject to the payment of the respective claims". The word "determination" is used in the sense as a "finding". At page 524 the Court also said:

> "We have already noted that *no adequate finding* was made as to the value of the assets of Consolidated. • • • **A determination of that value must be made** *so that criteria will be available to determine a proper allocation of new securities between the bondholders* and stockholders in case there is an equity remaining after the bondholders have been made whole".

It is evident therefrom that the Court did not merely hold that *data* was necessary but *that "findings" based on "data" were essential.*

The brief of RFC cites (p. 36) the decision in the *Missouri Pacific Railroad Reorganization* (39 F. Supp. 436) on the point that the determination of value is required in a case which proposes the elimination of stockholders *or the curtailment of rights of secured creditors.*

The decision states: "To justify such treatment it would seem *necessary to find* that the value of the property was insufficient to show any present value in the stock." Of course, the court arrived at the conclusion in that case that a finding was made because it held that the *capitalization* was "a finding of value". Another court arrived at the same conclusion in the case cited by RFC which held that the *finding as to capitalization* "is tantamount to a *finding of value*". Whether or not the distinction between "capitalization" and "valuation" was pointed out in these cases, we do not know. However none of their citations are applicable for the reason that the capitalization in the instant case includes *no par value stock at a stated value, and at no actual value,* so that the theory that the limit of the capitalization amounts to the limit of the value is inapplicable.

The authorities on the point that the determination of the Commission that there is no equity for stockholders is a finding as to value might be urged against the stockholders, but **has no application to the Adjustment Mortgage Bondholders** as there was no finding that the assets are insufficient to pay the Adjustment Mortgage Bonds and to what extent the assets were insufficient. *There is certainly no finding as to that class pertaining to valuation.*

Because of the express statutory requirement for a determination as to value when "*necessary*" for "*any purpose*" and due to the legal principles that here it was "necessary" under the plan which did make the creditors "whole" and which exchanged the new securities for the old, the Court of Appeals was compelled to say (R. 2316):

> "The explicit holding of the *Consolidated Rock Products* case is so mandatory that further discus-

sion is unnecessary. We can not accept the Commission's discussion of the evidence as a finding. Nor may we make findings, save where there is no dispute, or dispute is not serious, in order to sustain the plan.''

The same views were expressed by the Ninth Circuit in the *Western Pacific Railroad Company, supra*, where the Court said:

"To determine the value of the new first mortgage bonds, income bonds, new preferred stock and new common stock mentioned above, it was necessary to determine the value of (1) the debtor's entire property, (2) the property which would be subject to the new first mortgage and (3) the property which would be subject to the income mortgage.

Subsection (e) of § 77 provides: **'If it shall be necessary to determine the value of any property for any purpose under this section, the** (Interstate Commerce) **Commission shall determine such value and certify the same to the court in its report on the plan.'** In this case, as has been seen, it was necessary to determine the value of (1) the debtor's entire property, (2) each of the claims of Reconstruction Finance Corporation, (3) the claim of Railroad Credit Corporation, (4) the claim of A. C. James Company, (5) the claims of the holders of first mortgage bonds now outstanding, (6) the $10,000,000 of new first mortgage bonds, (7) the $21,219,075 of income bonds, *** * * It thus became the duty of the Commission to determine these values and certify them to the court. That duty was not performed.** (Emphasis ours.)

Lacking the requisite valuation data, the court was in no position to exercise the 'informed, independent judgment' which appraisal of the fairness of a plan of reorganization entails. *Consolidated Rock Products Co.* v. *Du Bois, supra.* See, also, *National Surety Co.* v. *Coriell*, 289 U. S. 426, 436; *First National Bank* v. *Flershem*, 290 U. S. 504, 525; *Case* v. *Los Angeles Lumber Products Co.*, 308 U. S. 106, 115.

Therefore, instead of approving the plan, the court should have entered an order dismissing the proceeding or, in its discretion and on motion of any party in interest, referring the proceeding back to the Commission for further action."

The decision in the instant case does not state as counsel contend that it is necessary with *mathematical* certitude to make findings of values, but that all that is necessary is to have a reasonable estimate. *The record is barren of such estimate.*

Counsel say (I. B. p. 32) that the statement in the opinion that there were absent from the report necessary findings was "technical", and they cite *Federal Communication* case (309 U. S. 134).* There, the court was concerned with "procedure" concerning the admissibility of evidence. There the court had the only power to *review* as it was limited to ascertain whether there was a compliance with "legal requirements". Here the court was required to have an "independent judgment" as pointed out in *Scripps Howard Radio* v. *Fed. Comm.*, 86 L. Ed. 826, 831.

They also say (p. 32) that the decision overlooked the fact that Congress conferred on the District Court the power of determining whether the plan should be sustained, which it fulfilled. The same Act provides for a review by the Court of Appeals. The Court of Appeals properly found that the District Court improperly approved the plan which failed to comply with Section 77.

* That such findings are not "technical" was pointed out in **Sanders Bros. Radio Co. v. Fed. Comm.**, 106 F. (2) 321, note 12, citing many decisions of this Court.

II. The plan failed to comply with § 77.

(a) Requirement of Statute.

Counsel refer (I. B. p. 33) to the Statutory requirements and omit the pertinent part (which appears in the Appendix vii) that:

> "If it shall be necessary to determine the value of any property for any purpose under this Section, the Commission shall determine such value, and certify the same to the Court in its report on the plan."

Through such "omission" and by the *inclusion* (p. 34) of the words that the Commission's report shall state "fully the reasons for its conclusion", they argue that the Statute was complied with. A similar argument is made by counsel for R. F. C. (pp. 27-28). We have already pointed out that the requirement to state the "reasons" relate to the *refusal* of a plan and *not to the approval of the plan*, which requires "determination of value".

The Brief of R. F. C. cites (p. 24) *United States* v. *Louisiana*, 290 U. S. 70, on the point that an "impracticable requirement" dispenses with the "necessity of finding". The Institutional Group quote at length from that decision (p. 43). *There was omitted from their quotation the words*: *"In the absence of some express provision"*. Here, **there is an express provision for finding when it is "necessary" for "any" purpose.** We have shown that the findings were necessary for the purpose of allocating the new securities when the creditors were not made "whole".

In *Florida* v. *U. S.*, 292 U. S. 1, on which counsel rely (I. B. p. 44; R. F. C. p. 29) the Court says: "The requirements of essential findings as to revenues, did not demand an impractical exactness." Respondents did not

contend that it was necessary for the Commission to find its valuation with impractical exactness, and the Court of Appeals made no such statement. There, this Court also said: "*Reasonable determinations were required and these were made.*" This is all that respondents require of the Commission, and this is all that the Court of Appeals wants the Commission to do, and which it failed to do.

The other cases cited (R. F. C. p. 29; I. B. pp. 44-45) as to "formal findings" are also inapplicable for the reason that here there are *no findings at all in the report as to valuations*, and the objections were not on the ground that the findings were not *formal*.

The above authorities were not overlooked in *Carter* v. *Kurn*, 120 F. (2) 261. There it was said:

> "While it is true that the requirement of essential findings does not require an impracticable exactness, nevertheless we think that unless specific finding is made * * * the interests of the consumers will not be given that consideration which Congress intended".

In *Sanders Bros. Radio Co.* v. *Fed. Comm.*, 106 F. (2) 321, the Court said:

> "In the absence of findings of basic facts the reviewing court cannot determine whether the lower tribunal acted properly in accordance with the evidence presented. The requirement, therefore, is not a mere technicality, being a safeguard of the interests of all concerned."

Contrary to the contention advanced here that the facts may be implied from the "reasons", this Court held on a previous appeal in the "Milwaukee" (*United States* v. *Milwaukee, St. Paul & P. Ry. Co.*, 294 U. S. 499) that *findings are essential*. There, Mr. Justice Cardozo said:

> "This Court has held that an order of the Interstate Commerce Commission is void unless supported by findings of the basic or *quasi*-jurisdictional facts * * * and in the absence of such finding, we are not called upon to examine the evidence in order to resolve opposing contentions as to what it shows or to spell out and state such conclusion of fact as it may present".

He cited another Florida case (282 U. S. 194). The decision was cited with approval in *United States* v. *Carolina Freight Com. Corp.* (1942), 86 L. Ed. p. 629. The requirement of *findings* by the Commission was reiterated in *Atchison Ry.* v. *United States*, 295 U. S. 193, cited recently in *Swift* v. *United States*, 62 S. Ct. 953, 86 L. Ed. 945, 948.

Counsel cite from the *dissenting* opinion in *Interstate Circuit Inc.* v. *U. S.* 304 U. S. 55, 58 (I. B. p. 45). But the *majority* opinion of this Court held that findings were essential.

(b) The Plan as presented by the parties and as modified and approved by the Commission.

The Institutional Groups who now seek the approval of the Plan, *concede* (p. 36) that they had previously sponsored a different Plan, *wherein the R. F. C. participated,* and which was not feasible and unfair. This constitutes a *confession of error in judgment* on the part of the two Petitioners as to the previous Plan which *they* then claimed to have been fair, equitable and feasible. If they and their counsel erred in their judgment as to the previous "stand-by" Plan, *they are not infallible from making another error in recommending the present Plan.*

(c) The changes sought by the respondents challenge the failure of the Commission and the District Court to make the proper determination within their respective jurisdictions.

Respondents as holders of Adjustment Mortgage Bonds are not interested in the argument relating to the objections of the stockholders. Their only present concern is with the second proposition argued by the Institutional Groups (p. 37) relating to the allotment of the securities given to them in exchange of their bonds. The Petitioners who sponsored the "stand-by" Plan in 1935, and continued to sponsor it up to 1938, and who were supported by the R. F. C., and who then brushed aside our objections to the *complicated capital structure* under that Plan, now seek the approval of the new plan (p. 38) on the ground that the present Plan does away with the complicated capital structure. *The remandment order does not change the Capital Structure.* It merely directed the Commission to make a determination as to value for the allotment of the new securities in exchange for the old, and in no way will the capital structure be changed, in the sense that different mortgages will be executed or retained as originally sponsored by the same group when they urged the "Stand-By" Plan.

III. In discharging its duties under Section 77, the Commission did not support the certified plan by any determination as to value which was necessary under the Plan.

(a) The Commission did not state its determination as to value as required under Section 77 (e).

The contention of the Institutional Groups (p. 42) that the Commission stated its findings in the same form which has been repeatedly determined by this Court, is devoid of merit for the reason that *there are no findings as to valuation in the report.* The argument that the requirements under §77 to state "fully the reasons for its conclusions" is a substitute for making findings was shown above to be baseless, as such requirement applies to a report *refusing* the approval of a Plan, and has no relation to a report *recommending the approval* of a Plan.

The Institutional Groups cite (p. 42) authorities on the point that findings of administrative bodies will be sustained against attack "for lack of formalism". These authorities apply to "findings", but have no application to reports of administrative bodies which are *barren of findings.* The attack here, was *not for the "lack of formalism"*, but for the lack of *any* findings on the vital issue in the case, namely, the valuation of the estate as a whole, and the valuation of the respective securities to be exchanged for the existing securities. Counsel for the Institutional Groups refer to the words "shall state fully the reasons for its conclusion", and say (p. 43) "*these are words of art so chosen as to avoid impractical requirements in regard to findings.*" The first part of the Section (App. iii) deals with a report and order approving a Plan, and the second part deals with a report and order

"in which it shall refuse any Plan", and it is *with "such report"* that the *"words of art"* are employed requiring the Commission to "state fully the reasons for its conclusions" for the *refusal* to approve the Plan.

It is contended (I. B. 47) that Congress could not have intended to require valuation of a railroad, in view of the difficulty of ascertaining the value. Some authorities are cited on the point that it is difficult to appraise valuations of railroads. **The Chairman of the Institutional Groups found no difficulty in testifying before the Commission as to the value of the railroad when he sought the approval of the "stand-by" Plan** and when he sought the approval of the Plan of the Institutional Groups (R. 724-6). The distinguished counsel, who now urge the approval of a Plan without valuation because of the impossibility to ascertain it are the same attorneys who brought out by the evidence of the Chairman of the Institutional Groups Committee *the valuation of the same railroad* when they sponsored their plan. **The "magnitude and difficulty" did not stop the petitioners from testifying as to the value of the railroad as a whole.** The argument that it is difficult to appraise a railroad has also been used by the same text writers and "experts" as to the difficulty to appraise the value of any large going concern, or property. Neither the Respondents nor the Court of Appeals demanded of the Commission anything that is impractical or an impossible "exactness". The Commission was asked to make findings as to reasonable values based on the evidence that is before it, so that from its determination the District Court in the first instance and the Court of Appeals on review might tell whether or not the Plan was fair and equitable.

That Congress did not intend that there be no appraisal of the value of a railroad appears from the very Act,

which it provides that if *necessary* the Commission shall *make determination* as to value. If Congress had intended that there be no valuations of railroad because of the *inability to make such valuation*, it would not have included the provision in §77 which deals exclusively with railroads. The requirement of valuation was conditioned on the word "necessary" not on the question whether it was possible. If Congress had in mind as urged by counsel for the Institutional Groups that the valuation of a railroad was impossible and if it considered the statement of the "experts" cited by the REC (pp. 32-33) it would not have imposed such a duty even if it was "necessary" as long as it could not be performed.

(b) The report does not contain any findings as to the valuation of the Debtor's property as a whole.

1. There is no determination of the value of the new securities available for distribution.

Under the heading "Findings as to Debtor's Property as a Whole", counsel for the Institutional Groups say (p. 49) that the report contains the data in order to determine the valuation. There is no dispute that the report contains the necessary data. The Court of Appeals said that, based upon the data, it was necessary for the Commission to determine the valuation. The Court of Appeals said "*the evidence might support a finding of a larger or smaller amount. Which should we accept? The fact finding body is the I. C. C. it must find.*"

After quoting from the Commission's report (I. B. p. 51) counsel say that the "Findings of the Commission as to the Debtor's property as a whole, and the permissible participation therein are sufficient." This statement is based on their confusion of capitalization with valuation. This was pointed out by the Court of Appeals (R. 2315)

which said: "It would be begging the question to assume that findings were necessarily made by the I. C. C. when the allocation was made."

It further said, "Our criticism is not directed to the fact that the findings were embodied in the Commission's report rather than stated specifically as findings, *but the fault lies in the fact that we are left uncertain or in the dark as to the findings of the Commission.*"

2. Exclusion of the preferred and common stock.

The respondents, as Adjustment Bondholders, are at present not interested in this issue. However, the fact that in the present reorganization the preferred and common stock is being completely wiped out on the theory that creditors must be made "whole" before anything is given to stockholders, has a bearing on the issue of the fairness of the exchange of the Adjustment Mortgage Bonds for common stock without voting rights. If the senior security holders should want to foreclose at the present time, the Adjustment Mortgage Bondholders would have their redemption rights. They would also have an equal claim on the free assets with the senior securities as to any deficiency. Under the proposed Plan, if there should be a default in any of the terms of the new securities, the new common stock will be completely wiped out, and it is, therefore, not a fair exchange.

(c) Findings as to Additions and Betterment Fund.

Respondents did not assign error below concerning this point which is argued by counsel (I. B. pp. 64-68) and no answer is, therefore, necessary on their part.

(d) The Findings as to Each of the Several Mortgage Divisions.

Under this point counsel for the Institutional Groups discuss the fairness of the division of the securities among the respective mortgages. Respondents are only concerned with such discussion as it relates to the Adjustment Mortgage Bonds (pp. 77-79) and which argument is practically identical in the brief of the R. F. C. (pp. 68-72). They quote (I. B. p. 78; R. F. C. p. 69) from the Commission's Report dealing with the allotment to the Adjustment Mortgage Bondholders and say that the Commission found that the allotment of stock "will fail to satisfy the claim (of the Adjustment Mortgage Bondholders) of $55,471,653". They do not, however, discuss the question how the Commission arrived at its conclusion. It is evident from the quotation that the conclusion was based on the *stated value* of $100 per share for each of the new common stock. What if these shares are actually worth more or less? This would make a difference as to what they received in exchange in the alleged deficiency in excess of $55,000,000. *There is no basis for the conclusion, in the absence of a determination of the actual value of the common stock.*

The Institutional Groups refer (p. 79) to the opinion of the District Court on the point that the Commission allotted to the Adjustment Mortgage Bondholders out of the permissible capital structure "all that was left after satisfying prior claims". They also say that the Court of Appeals "made no analysis" of the report on the allocation "other than to state that more findings were necessary". We are only concerned with the judgment of the Court and we may urge any reason in support thereof whether or not the reasons or the analysis appears in the opinion.

It appears from the allocations to the respective secured holders from the chart contained in the brief of the Institutional Groups (p. 15) that 318,077 of the common shares were allotted to the holders of the 50-year mortgage. If there was a determination as to the value of these shares then the Commission's conclusion that the deficiency ot Adjustment Mortgage Bondholders will be approximately $55,000,000 would be logical. However, there is no finding as to the value of these shares. *The amount that is left for this class must be determined by the value of the common stock which was given to the 50-year mortgage bondholders* so that it cannot be said that the Adjustment Mortgage Bondholders received "all that was left after satisfying prior claims". Besides, general creditors become partners with the Adjustment Mortgage Bondholders as holders of the common stock and in the absence of a finding as to the value of the stock it cannot be determined how much the general creditors are receiving out of the free assets on which the Adjustment Mortgage Bondholders have a claim.

Counsel for the R. F. C. restate the argument of counsel for the Institutional Groups (pp. 68-72) but add that "all necessary findings have been made by the Commission". **We challenge them to point out anything in this record which contains any finding as to the value of the new common stock which is to be allotted to the Adjustment Mortgage Bondholders in payment of their debt in excess of $262,000,000.**

CONCLUSION.

The Circuit Court of Appeals was correct in its view that in the absence of a determination of values both as to the entire estate of the Debtor and as to the allotted securities, the report of the Commission and the order of the approval thereof by the District Court cannot be confirmed and it properly reversed the order with directions to make further findings. Its decision should be affirmed here.

Respectfully submitted,

MEYER ABRAMS,
Counsel for Israel A. Abrams, et al., Holders of Adjustment Mortgage Bonds, Respondents.

SHULMAN, SHULMAN & ABRAMS,
134 N. LaSalle St.,
Chicago, Illinois.